Interactive
Tax Gap Map

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Department of the Treasury
Internal Revenue Service
NHQ Office of Research

TAX GAP MAP for Tax Year 2001 *(in $ Billions)*

Total Tax Liability
$2,078.0

Tax Paid Voluntarily & Timely
$1,767.4
(Voluntary Compliance Rate: VCR = 85.1%)

Gross Tax Gap: $310.6
(Noncompliance Rate: NCR = 14.9%)

—

Enforced & Other Late Payments
$55.4 *

=

Net Tax Gap
(Tax Not Collected)
$255.2

Nonfiling
$30.1

- Individual Income Tax $28.1
- Corporation Income Tax ?
- Employment Tax ?
- Estate Tax $2.0
- Excise Tax ?

Underreporting
$248.8

- Individual Income Tax $148.8
  - Non-Business Income $38.1
  - Business Income $81.2
  - Adjustments, Deductions, Exemptions $16.7
    - Dup. TINs $0.4
  - Credits $12.8
    - EITC $8.9
- Corporation Income Tax $29.9
  - Small Corporations (Under $10M) $4.9
  - Large Corporations (Over $10M) $25.0
- Employment Tax $66.1
  - FICA $14.3
  - Self-Employment Tax $51.2
  - Unemployment Tax $0.6
- Estate Tax $4.0
- Excise Tax ?

Underpayment
$31.7

- Individual Income Tax $19.4
- Corporation Income Tax $2.3
- Employment Tax $7.2
- Estate Tax $2.3
- Excise Tax $0.5

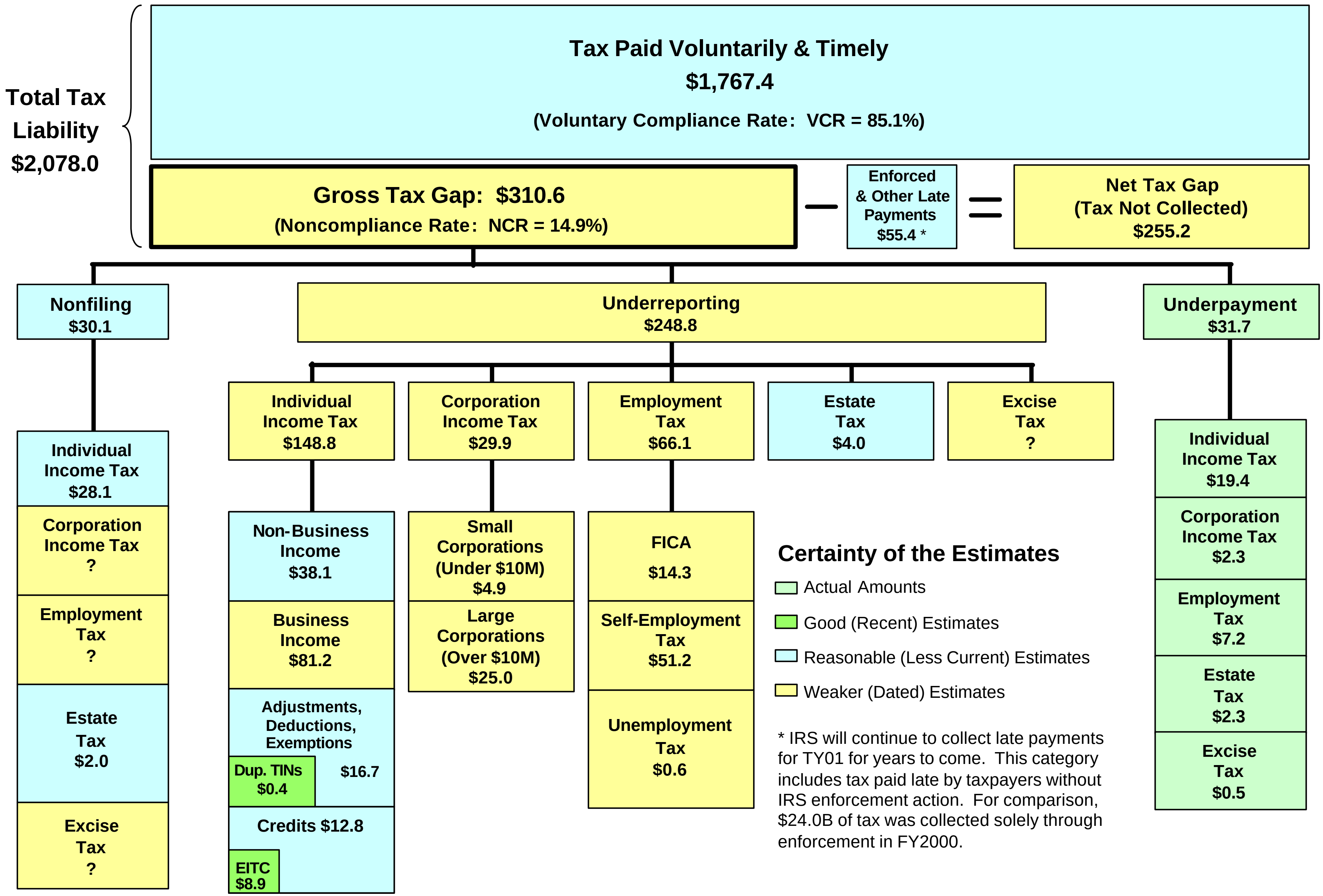
Certainty of the Estimates

- Actual Amounts
- Good (Recent) Estimates
- Reasonable (Less Current) Estimates
- Weaker (Dated) Estimates

* IRS will continue to collect late payments for TY01 for years to come. This category includes tax paid late by taxpayers without IRS enforcement action. For comparison, $24.0B of tax was collected solely through enforcement in FY2000.

IRS NHQ Office of Research • March 31, 2004

TAX GAP MAP for Tax Year 2001 *(in $ Billions)*



Certainty of the Estimates

The tax gap figures presented here range from actual amounts to very rough estimates. Our confidence in them depends on both the quality of the original estimates and how many years they have been projected beyond the original data.

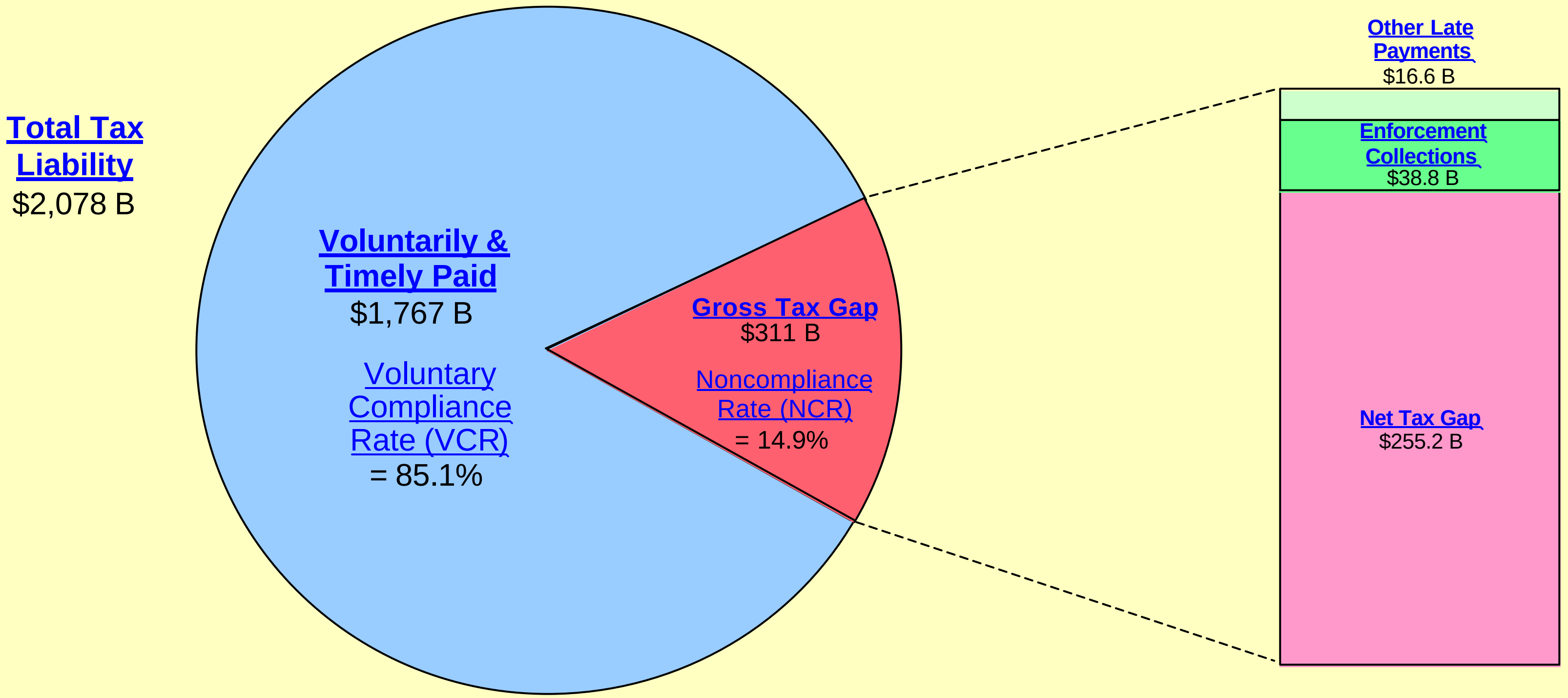
Tax Gap Component	TY2001 Projection ($B)	Confidence in Original Estimate			Age of the Compliance Data			Overall Confidence in Projection
Nonfiling								Reasonable
Individual income tax	28.1		Medium		Dated			Reasonable
Estate tax	2.0		Medium			Less current		Reasonable
Underreporting								Weaker
Individual income tax								Weaker
• Non-business income	38.1		Medium		Dated			Reasonable
• Business income	81.2	Low			Dated			Weaker
• Adjustments, deductions, exemptions	16.7		Medium		Dated			Reasonable
Duplicate TINs			Medium				Recent	Good
• Credits	12.8		Medium		Dated			Reasonable
EITC			Medium				Recent	Good
Corporation income tax								Weaker
• Small corporations	4.9	Low			Dated			Weaker
• Large corporations	25.0	Low			Dated			Weaker
Employment tax								Weaker
• FICA	14.3	Low			Dated			Weaker
• Self-employment tax (SECA)	51.2	Low			Dated			Weaker
• Unemployment tax (FUTA)	0.6	Low			Dated			Weaker
Estate tax	4.0		Medium			Less current		Reasonable
Underpayment	31.7			High			Recent	Actual

What updates are being planned?

Return to Tax Gap Map FAQs Previous Slide Next Slide Return to Last Slide Viewed Exit

Overview of the TY2001 Gross Tax Gap and Its Disposition

Overall, Taxpayers Did Not Pay About 15% of Their 2001 Tax Voluntarily and Timely, And Only $55 Billion (17.8%) of That Tax Gap Will Likely Be Recovered



Note: *These totals include all components of all types of tax for which estimates are available. The most notable exclusion is excise tax. With the exception of the underpayment gap, all of the estimates are projected from compliance data from TY88 and earlier.*

Total Tax Liability

- This is the total amount of tax that is imposed on legal-sector activities by the Internal Revenue Code and related regulations **for a given tax year**.
- This is the sum of:
  - True tax liabilities that are paid voluntarily and timely, plus
  - True tax liabilities that are ***not*** paid voluntarily and timely (the gross tax gap).
- Total tax liability must be estimated, since most of the tax gap cannot be observed and must therefore be estimated.
- Total tax liability must be estimated separately for each type of tax.
- The amount shown is the sum of all tax liabilities that have been estimated. It does not include the corresponding tax liability for any component on the Tax Gap Map that does not include a specific estimate.

Tax Paid Voluntarily and Timely

- This is the portion of Total Tax Liability that is paid voluntarily and timely.
- “Voluntarily” means without direct enforcement contact by the IRS.
- “Timely” means on or before the date it is due by law or regulation (though some estimates incorporate a small tolerance of a week or so to account for differences between the date a taxpayer fulfills his obligation and the date when it is processed by the IRS).
- Note that payment due dates are sometimes different from return due dates (extensions for which generally do not also extend the payment due date).
- Since our tax gap estimates are for entire tax years, when periodic payments are due throughout the year, they are generally considered timely for tax gap purposes if they are paid on or before the last payment due date for the tax year in question.

Voluntary Compliance Rate

$$\text{VCR} = \frac{\text{Tax Paid Voluntarily \& Timely}}{\text{Total Tax Liability}} \times 100$$

- This overall measure of voluntary compliance combines all three components of taxpayers' obligations: filing compliance, reporting compliance, and payment compliance.
- Since Total Tax Liability cannot be observed, the VCR must be estimated also.
- This is generally an aggregate measure for the entire population for a given tax year. However, it can sometimes be estimated for:
  - One type of tax, or two or more taxes combined;
  - Sub-populations.
- Note that the Voluntary Compliance Rate is *not* a percentage of taxpayers, but of tax dollars.
- The Voluntary Compliance Rate = 100 – Noncompliance Rate.

Gross Tax Gap

- The Gross Tax Gap is the amount of tax that is imposed by law for a given tax year, but is not paid voluntarily and timely.
- Gross Tax Gap = Total Tax Liability – Tax Paid Voluntarily and Timely
- The Gross Tax Gap is the sum of three components:
  - The **Nonfiling Gap**;
  - The **Underreporting Gap**; and
  - The **Underpayment Gap**.

Scaled Overview

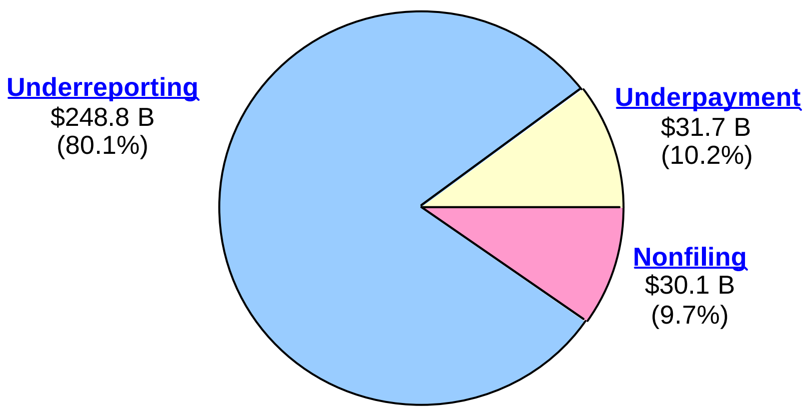
- Note that timely overpayments by a taxpayer count as full payment for that taxpayer; they do not offset the underpayments of other taxpayers.
- TY2001 Gross Tax Gap Estimates and Components (in $ Billions):

Component	Individual Income Tax	Corporation Income Tax	Employment Tax	Estate & Gift Tax	Excise Tax	TOTAL
Nonfiling Gap	28.1	?	?	2.0	?	30.1
Underreporting Gap	148.8	29.9	66.1	4.0	?	248.8
Underpayment Gap	19.4	2.3	7.2	2.3	0.5	31.7
Total (Gross Tax Gap)	**196.3**	**32.2**	**73.3**	**8.3**	**0.5**	**310.6**

Tax Year 2001 Gross Tax Gap

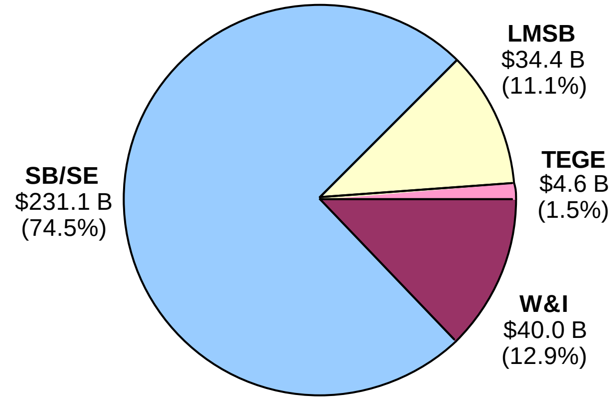
Dominated By the Underreporting of Business Income by Individuals

By Type of Noncompliance

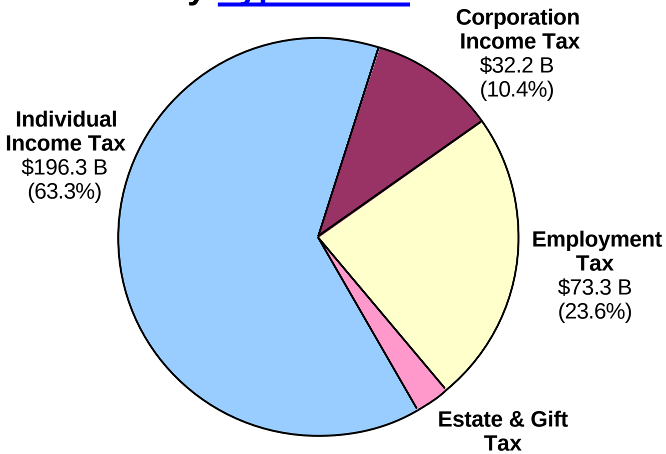


** Excludes excise tax.*

By Operating Division

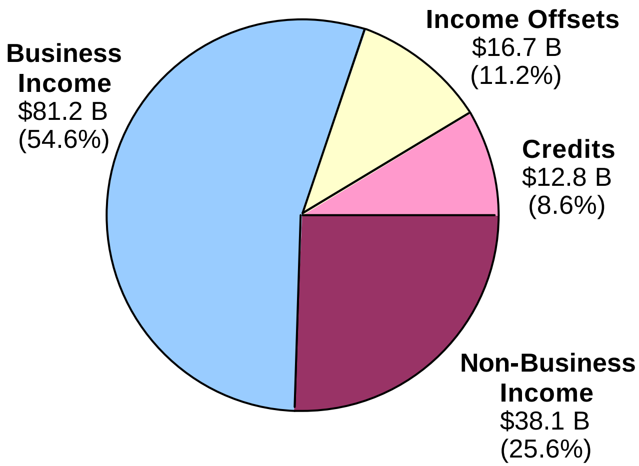


By Type of Tax *



** No estimates for excise taxes are available other than underpayment gap.*

Components of the Individual Income Tax Underreporting Gap

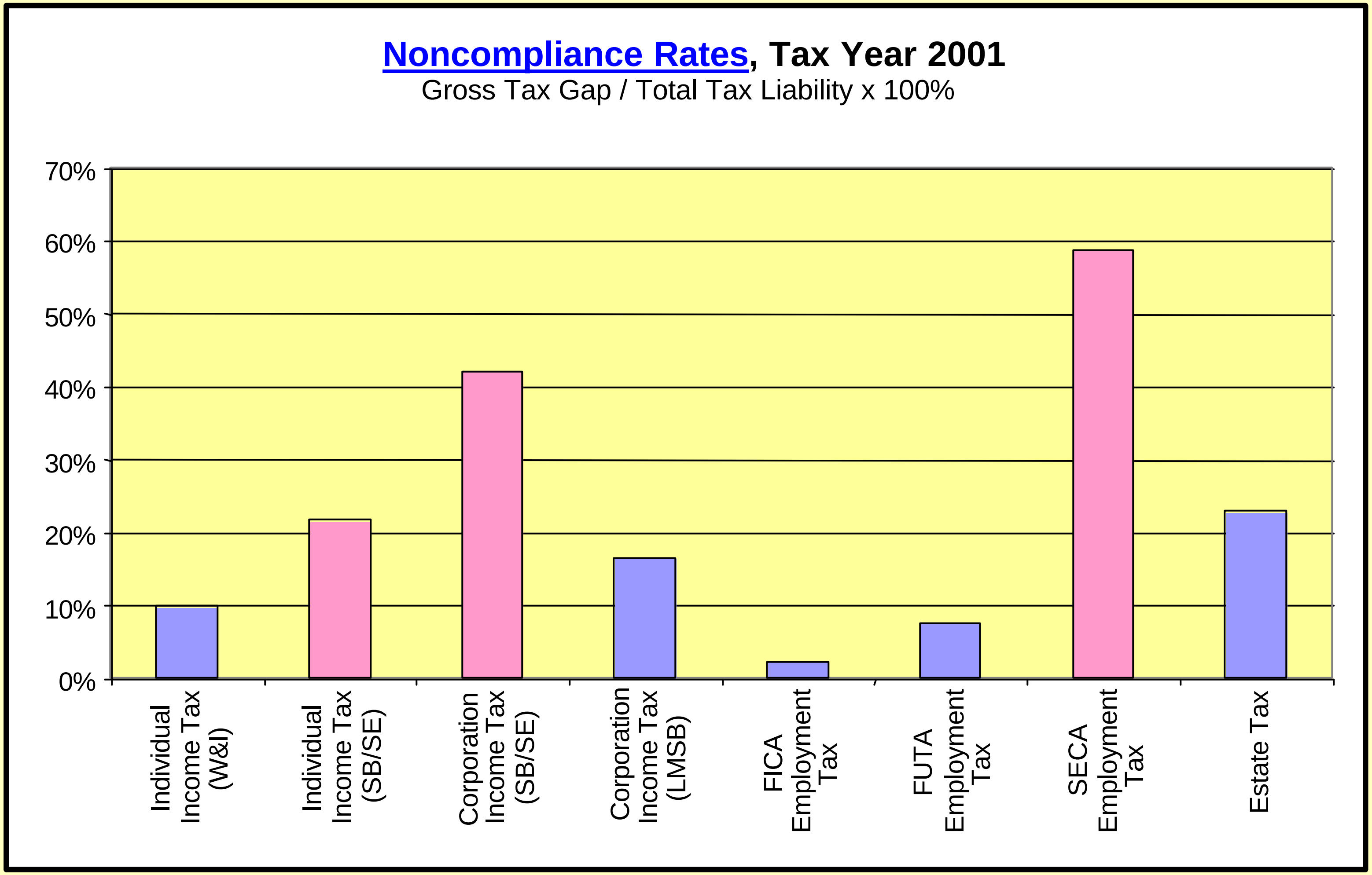


Noncompliance Rate

$$NCR = \frac{\text{Gross Tax Gap}}{\text{Total Tax Liability}} \times 100$$

- This overall measure of noncompliance combines all three components of taxpayers' obligations: filing compliance, reporting compliance, and payment compliance.
- Since neither the Tax Gap nor Total Tax Liability can be observed, the NCR must be estimated also.
- This is generally an aggregate measure for the entire population for a given tax year. However, it can sometimes be estimated for:
  - One type of tax, or two or more taxes combined;
  - Sub-populations.
- Note that the Noncompliance Rate is *not* a percentage of taxpayers, but of tax dollars.
- The Noncompliance Rate = 100 – Voluntary Compliance Rate.

Noncompliance Rates for Major Categories



Enforced and Other Late Payments

- These are portions of the Gross Tax Gap that are paid, but not paid timely.
- **Enforced payments** result from IRS filing and post-filing actions, such as:
  - Imposing "math error" adjustments during return processing;
  - Offsetting tax refunds to satisfy other unpaid assessments;
  - Matching third-party information documents against filed tax returns;
  - Examining (auditing) filed tax returns;
  - Securing delinquent returns;
  - Collecting unpaid tax assessments.
- **Other late payments** are amounts that are paid without IRS contact, but are paid late. These amounts are not routinely tracked by any system, and are estimated. (The Enforcement Revenue Information System, ERIS, focuses on enforcement payments, and does not include many non-enforced late payments.)
- Since the tax gap and total tax liability include only tax amounts, any amounts of penalties and interest that are paid are excluded from enforced and other late payments for tax gap purposes.
- Since the tax gap and tax liability are *tax year* concepts, these payments relate to the same tax year. Therefore, they accumulate over many fiscal years.

Net Tax Gap

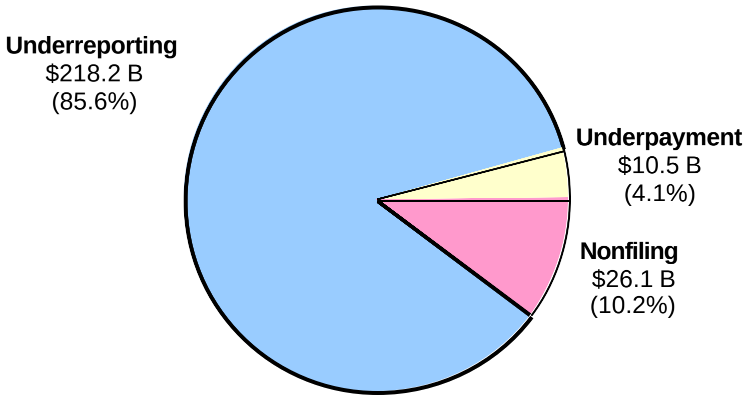
- The Net Tax Gap is the portion of the Gross Tax Gap that will not be collected after all IRS and taxpayer actions have been completed for a given tax year.
- Net Tax Gap = Gross Tax Gap – Enforced and Other Late Payments
- Like the Gross Tax Gap and Enforced and Other Late Payments, the Net Tax Gap is a *tax year* concept.
- The Net Tax Gap for future years can be reduced by reducing the Gross Tax Gap (i.e., by increasing voluntary compliance), or by increasing the payments arising from enforcement.

Scaled Overview

Tax Year 2001 Net Tax Gap

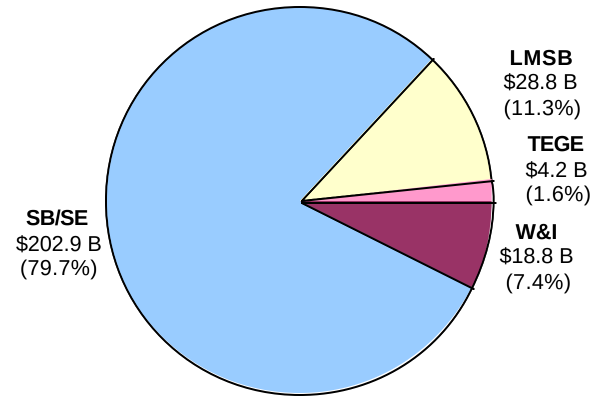
Dominated By the Underreporting of Business Income by Individuals

By Type of Noncomplianc

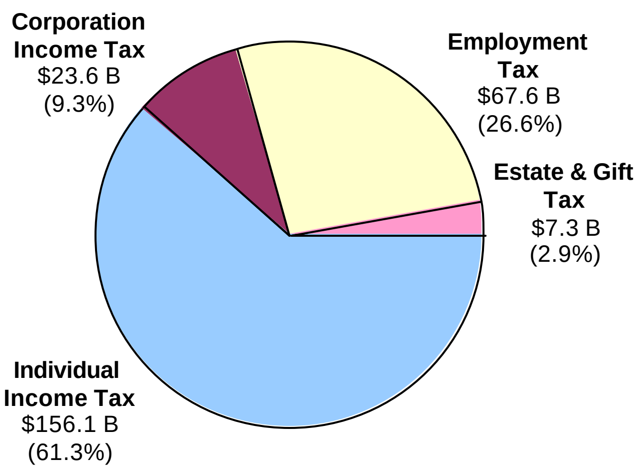


** Excludes excise tax.*

By Operating Division

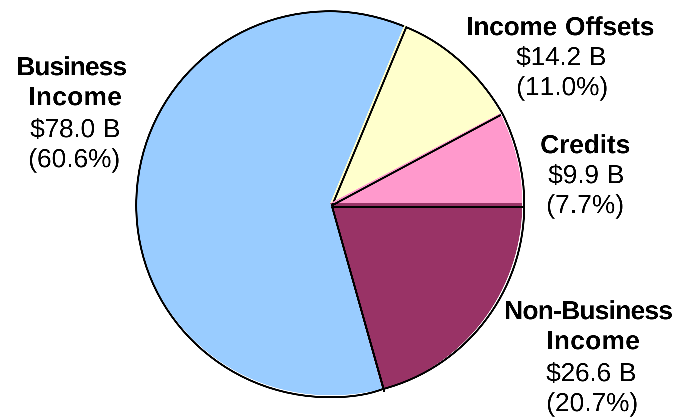


By Type of Tax



** No estimates for excise taxes are available other than underpayment gap.*

Components of the Individual Income Ta
Net Underreporting Gap



NOTE: *These estimates are even less reliable than the gross tax gap estimates.*

Nonfiling Gap

- The Nonfiling Gap is the tax that is owed but not paid voluntarily and timely by those who fail to file required returns by their due date.
- Note that by this definition, the nonfiling gap is net of any tax paid by or on behalf of these taxpayers before the due date of the return (e.g., through withholding), and that this includes the gap generated by those who file late.

	Total Tax Liability of those required to file tax returns, but who do not do so timely (i.e., by the return due date)
—	Tax paid timely (i.e., by the payment due date) by those required to file tax returns, but who do not do so timely (i.e., by the return due date)
=	**Nonfiling Gap**

- We have estimates of the Nonfiling Gap for:
  - Individual income tax, and
  - Estate tax

Individual Income Tax Nonfiling Gap

- This estimate is based on the Tax Year 1988 Nonfiler Taxpayer Compliance Measurement Program (TCMP) study. This study had two segments:
  - A sample of apparent nonfilers who were attempted to be located, and from whom delinquent returns were attempted to be secured, if applicable. (The balance due reported on the secured delinquent returns was projected to the entire population.)
  - A subsample of the secured delinquent returns, which was subjected to the same line-by-line audits as the timely-filed returns examined in the Tax Year 1988 Filer TCMP. (The additional understatement of tax derived from the detailed examinations of this subsample was also projected to the entire population.)
- The estimates of the nonfiling gap account for the probability that an individual with particular observed characteristics would be located, so that the examined returns represented all nonfilers—whether locatable or not.
- Estimates for subsequent tax years assume a constant relationship between the Nonfiling Gap and the Underreporting Gap.

Estate Tax Nonfiling Gap

- This estimate is based on two external surveys* administered by the Institute for Social Research at the University of Michigan to estimate the number of estate tax returns required to be filed and the corresponding amount of tax liability.
- These estimates control for household wealth, marital status, individual mortality, and the interaction between these factors.
- The estimated number of estate tax returns and the tax reported on them were obtained from IRS's Statistics of Income (SOI) samples.
- Our estimate of the gap is the difference between our estimate of estate tax obligations and the actual behavior.

* The Asset and Health Dynamics among the Oldest Old (AHEAD) dataset, and the Health and Retirement Study (HRS). They provide extensive economic, financial, demographic, and health information about older Americans.

Underreporting Gap

- The Underreporting Gap is the amount of tax that is owed by those who timely file their returns, but which they do not report on those returns—for whatever reason (e.g., ignorance, forgetfulness, negligence, willful evasion, etc.).
- The underreporting gap is net of the amount of tax that taxpayers overstate on their tax returns.

	Total Tax Liability of timely filers
—	Tax reported on those timely returns
=	**Underreporting Gap**

- We have estimates of the Underreporting Gap for:
  - ➢ Individual income tax,
  - ➢ Corporation income tax,
  - ➢ Employment tax, and
  - ➢ Estate tax

Individual Income Tax Underreporting Gap

- This estimate is based primarily on the Tax Year 1988 TCMP survey of timely filed returns—thorough audits of a representative sample of the entire filing population.
- The estimate also accounts for the extent to which the TCMP survey was unable to represent all types of taxpayers and all underreporting.
  - The underreporting tax gap estimates for two types of income—tip income and "informal supplier"[1] income—were based on other sources of data, gathered in IRS-sponsored studies by university research teams[2].
  - In addition, the TCMP-based estimates of unreported income were enlarged to account for the extent to which the TCMP examiners could not detect all unreported income. This adjustment was based on a special study of a subsample of the Tax Year 1976 TCMP, which was the last TCMP survey in which the examiners did not have access to third-party information documents during the examinations. The 1976 TCMP-IRP study data revealed that for every dollar of unreported income detected in the TCMP examination that would have been detected with the aid of the information documents, generally another $2.28 of underreporting revealed by IRP documents went undetected. We therefore multiplied all TCMP adjustments to income by 3.28 if they were detected without the aid of IRP information.
- In extrapolating from 1988 to 2001, we assumed that reporting compliance percentages by type of income or offset were constant.

[1] Informal suppliers are sole proprietors who operate in an informal style—often on a cash basis and "off the books." They could operate such activities as street vending, door-to-door sales, childcare, or moonlighting in a trade or profession.

[2] The unreported tip income estimates are based on a University of Illinois study of restaurants and other eating places for 1984, and the informal supplier estimates are based on two University of Michigan surveys of consumers—one for 1981, and another for 1985-1986.

Individual Income Tax Underreporting Gap

Recent Estimates for Two Sub-Parts of the Underreporting Gap

- Duplicate Taxpayer Identification Numbers (TINs): A recent IRS study estimated that about $0.4 billion of tax was underreported annually on returns claiming dependents who were already claimed on another return. This is a portion of the amount underreported due to overstated exemptions.
- Earned Income Tax Credit (EITC): A recent IRS study estimated that about $8.9 billion of EITC was overclaimed (net of underclaims) on Tax Year 1999 returns filed by EITC claimants. The study was based on audits of a random sample of EITC returns.

Note: These two estimates on the Tax Gap Map are really "memo" entries for information only. They are not components of the current estimate of the underreporting gap. When new estimates of the entire individual income tax underreporting gap are developed in the near future, those new estimates will supercede both our current projection of the gap *and* these memo entries.

Individual Income Tax Underreporting Gap

- This estimate is comprised of four main components:
  - Non-Business Income
  - Business Income
  - Offsets to Income (Adjustments, Deductions, Exemptions)
  - Offsets to Tax (Credits)
- A measure of aggregate underreporting for each tax return line item is the **Net Misreporting Percentage**:

$$\text{NMP} = \frac{\Sigma \text{ Net Misreported Amount}}{\Sigma \text{ | Amount That Should Have Been Reported |}^{*}} \times 100$$

* Taking the absolute value of the correct amounts allows losses to be aggregated with gains.

- The following slides provide the estimated NMPs for the major line items for Tax Year 1992, and show that the NMP is roughly proportional to the "visibility" of the item being reported.

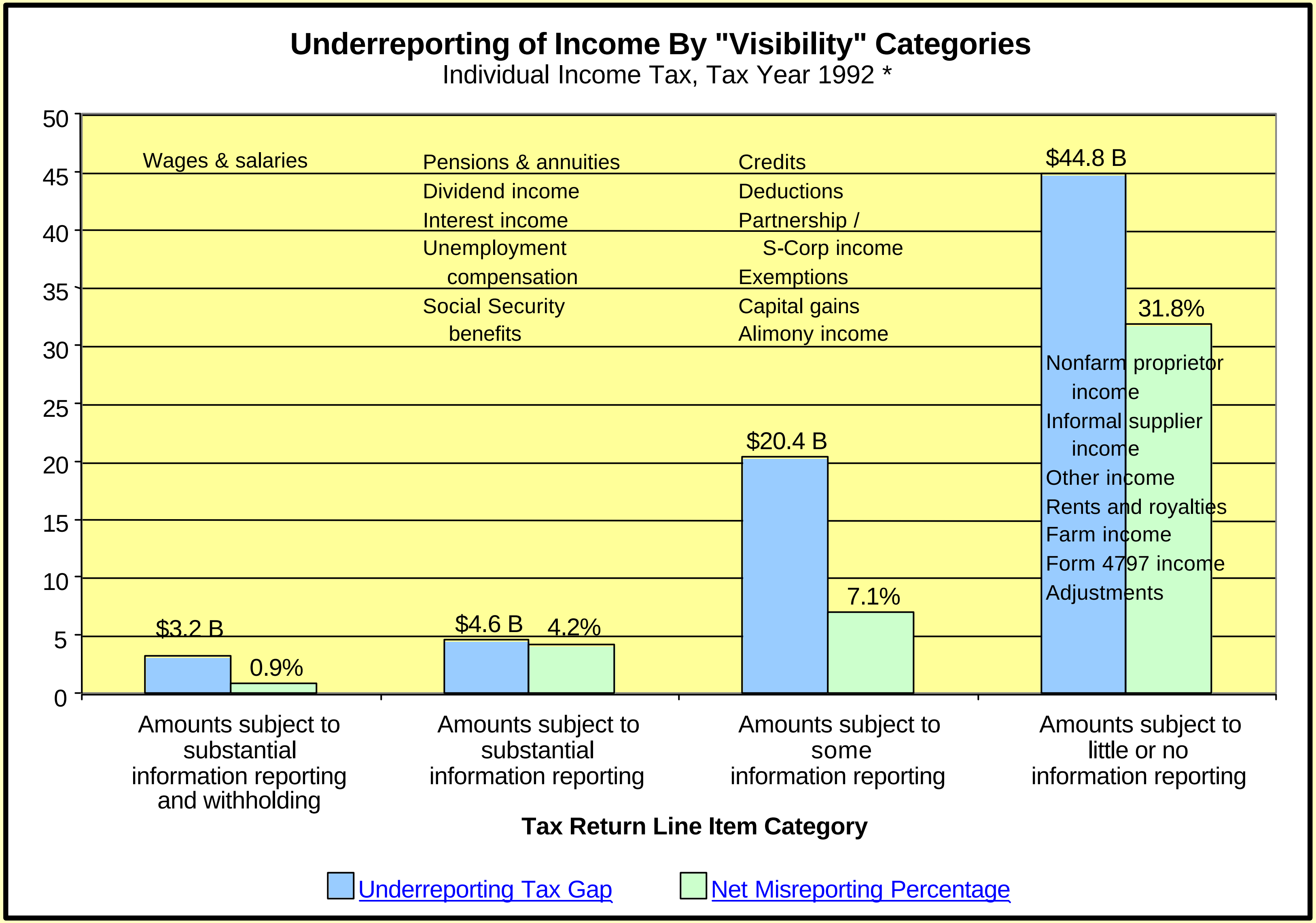
Tax Year 1992* Individual Underreporting Gap and NMP Detail

	Gross Underreporting Tax Gap ($B)	Net Amount of Misreported Income or Offset ($B)	Net Misreporting Percentage
TOTAL	**73.1**	**331.9**	
UNDERREPORTED INCOME	**58.6**	**283.7**	
Non-Business Income	***18.7***	***95.2***	***2.6***
Wage Income	3.2	24.0	0.9
Interest Income	0.9	3.6	2.3
Dividend Income	1.3	6.1	7.8
State Tax Refunds	0.0	0.1	0.8
Alimony Income	0.1	0.3	13.3
Pensions and Annuities	1.8	8.6	4.0
Unemployment Compensation	0.3	2.3	6.9
Social Security Benefits	0.2	1.0	4.2
Capital Gains	2.5	9.4	7.2
Form 4797 Income	0.7	3.9	28.0
Other Income	7.6	35.9	24.9
Business Income	***39.9***	***188.5***	***30.0***
Nonfarm Proprietor Income	16.9	74.4	32.3
Informal Supplier Income	12.3	59.6	81.4
Farm Income	3.4	17.9	32.2
Rents and Royalties	3.7	19.4	17.2
Partnership and S-Corp. Income	3.6	17.2	7.5
OFFSETS TO INCOME	**8.2**	**42.0**	**4.4**
Adjustments	***0.2***	***0.7***	***2.0***
Deductions	***5.1***	***19.9***	***4.4***
Exemptions	***2.9***	***21.4***	***4.5***
OFFSETS TO TAX (Credits)	**6.2**	**6.2**	**40.2**
NET MATH ERRORS	**0.1**		

* Tax Year 1992 is the last year for which line-item compliance measures have been published. See Publication 1415 (Rev. 4-96).

NMP vs. "visibility"

Individual Income Tax Underreporting Gap



* Tax Year 1992 is the last year for which line-item compliance measures have been published.
See Publication 1415 (Rev. 4-96).

Line-item Detail

Corporation Income Tax Underreporting Gap

- This estimate has two major components:
  - Small Corporations (those reporting assets of $10 million or less)
  - Large Corporations (those reporting assets of more than $10 million)

The next two slides summarize the data and methodology used to estimate these components of the tax gap.

Small Corporation Income Tax Underreporting Gap

- Small corporations are those reporting assets of $10 million or less.
- This estimate is based primarily on the Tax Year 1977 and 1980 TCMP surveys of timely filed returns—thorough audits of a representative sample of the entire filing population.
- The estimate accounts for the extent to which the TCMP survey was unable to detect all underreporting, using the same methodology and factors developed for individual income tax.
- In extrapolating from 1980 to 2001, we assumed that the reporting compliance percentage remained constant.

Large Corporation Income Tax Underreporting Gap

- Large corporations are those reporting assets of more than $10 million. In addition, Unrelated Business Income Tax (UBIT) and Fiduciaries were included here for reporting simplicity.
- This estimate is based on both TCMP audits and routine (operational) audits, averaged over three years in the mid-1980s, and was made in four parts:
  - Mid-Sized Corporations (assets of $10-$100 million): Operational audit results were projected to the entire population using "yield curves" (expressing average audit yield as a function of audit coverage rate), which were developed by the IRS Examination function for each of two classes of corporation returns (assets of $10-$50 million and $50-$100 million).
  - Large Corporations (assets of $100 million or more): Operational audit results were taken directly, without adjustment, as the underreporting gap. Yield curves were not available to project to 100 percent audit coverage, but operational audit coverage among these corporations was around 86 percent back then, and little additional noncompliance was thought to exist.
  - Unrelated Business Income Tax (UBIT) of Tax-Exempt Organizations: The reporting compliance percentage is based on a TCMP study for Tax Year 1983, applied equally to all categories of exempt organizations that file income tax returns. However, the noncompliance rate also reflects an adjustment to account for the fact that the TCMP sample excluded organizations that had assets exceeding $50 million. This adjustment was derived using operational audits of large organizations that were conducted for the same year.
  - Fiduciaries: The reporting compliance percentage for income tax returns filed by fiduciaries (individuals or other legal entities who serve as trustees, guardians, or executors of estates) on behalf of estates is based on a TCMP study conducted for Tax Year 1975. We used this rate without any adjustments.
- In extrapolating from the Tax Year 1982 estimate for all four parts combined, we assumed that the reporting compliance percentage remained constant.

Employment Tax Underreporting Gap

- Includes several taxes that are paid by employers and the self-employed:
  - Social Security and Medicare taxes (Federal Insurance Contributions Act [FICA] and the Self-Employment Contributions Act [SECA])
  - Federal Unemployment Insurance taxes (FUTA)
- **FICA and SECA:** We derived FICA and SECA noncompliance rates by estimating the Social Security and Medicare tax gap separately for each of three components.
  - Additional FICA tax due on underreported tip income (estimated for our individual income tax gap report);
  - Additional FICA and SECA tax due on underreported wage and salary income (based on a special withholding noncompliance study for Tax Year 1984. This study encompassed both the underreporting of employee earnings and the misclassification of employee remuneration as earnings from self-employment, in which case both the employer and employee shares of FICA taxes were typically underpaid simultaneously.);
  - Additional SECA tax due on underreported self-employment income (which was estimated by our individual income tax gap model).
- **FUTA:** Estimates of FUTA noncompliance are based on the same data and approach as for FICA and SECA, but they involve only two of the three components outlined above: underreported tip income, and underreported wages and salaries.

Estate Tax Underreporting Gap

- We used two IRS datasets (both developed by IRS' Statistics of Income Division) to estimate the tax gap associated with filed estate tax returns for Tax Year 1992.
  - ➢ The Estate Tax Return Sample (ETRS), which contains detailed return information on a representative sample of the estate tax filing population, allowed us to estimate the amount of tax voluntarily reported on those returns.
  - ➢ The Estate Post-Audit Study (EPAS), which provides supplementary audit information for a subsample of the ETRS dataset, allowed us to estimate how much tax *should have been* reported in the filing population. This last estimate required that we account for the fact that the returns for which we had audit results were not representative of the entire population, such as in a TCMP survey. To do this, we controlled for an estimated probability of being audited.
- The estimates for later tax years were developed by applying the Tax Year 1992 noncompliance rate to actual receipts for the year in question (reduced by the ratio of voluntary payments to total receipts—94.4 percent—derived for 1992).

Excise Tax Gap

- We do not have any estimates of the excise tax nonfiling or underreporting gaps. Given the relative simplicity of excise tax computations, it would appear straightforward to estimate total tax liability using industry and government data on the dollar value of taxable transactions, then subtract the amount of tax voluntarily and timely paid in the aggregate. This has proven impractical, however, for two major reasons:
  - There are many different federal excise taxes, many with specific exclusions or varying applications.
  - The data on taxable transactions is typically maintained at the state level, and is often incomplete. Estimates of total liability based on these data often are less than the corresponding amounts of tax actually paid, implausibly suggesting a negative tax gap.
- We plan to test whether the transaction data that exist can be sampled, or otherwise projected more accurately to the population—at least for some types of excise tax.

Underpayment Gap

- The underpayment gap is the amount of tax that is reported on timely-filed returns, but is not paid voluntarily and timely.
- These amounts are now routinely tabulated from the IRS Master File.
- Ideally, these tabulations would include the employer underdeposit of withheld income tax as part of the individual income tax underpayment gap. However, the current tabulations do not identify all employer underdeposits of withheld income tax, nor do they separate it from the employment tax underpayment gap. Programming modifications are being made to correct these minor deficiencies.
- As with other components of the tax gap, these amounts exclude interest and penalties.
- The underpayment gap is not the same as the Accounts Receivable Dollar Inventory (ARDI), which is a cumulative accounting of all unpaid assessments of tax, penalty, and interest—including assessments arising from nonfiling and underreporting.

The underpayment gap for recent years

Underpayment Gap

As of February 14, 2003

By Type of Tax and By Tax Year	Individual Income Tax			Corporation Income Tax			Employment Tax			Excise Taxes			Estate and Other Taxes		
	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001
Gross Gap ($B)	19.8	24.7	19.4	7.2	2.4	2.3	6.5	8.7	7.2	0.5	0.4	0.5	2.3	4.9	2.3
VPCR *	97.7%	97.5%	97.8%	96.0%	98.4%	98.5%	99.4%	99.3%	99.4%	99.1%	99.0%	99.1%	94.7%	98.0%	92.9%
Net Gap after 1 year	4.1	8.1		5.3	2.6		3.4	3.6		0.1	0.1		1.8	1.3	
CPCR **	99.5%	99.2%		97.0%	98.7%		99.7%	99.7%		99.7%	99.7%		95.8%	94.0%	
Net Gap after 2 years	3.3			5.3			3.3			0.1			1.8		
CPCR **	99.6%			97.0%			99.7%			99.7%			95.8%		

By Operating Division and By Tax Year	Wage & Investment			Small Business / Self-Employed			Large & Mid-Size Business			Tax Exempt / Gov't Entity			Total		
	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001	1999	2000	2001
Gross Gap ($B)	4.1	7.2	4.3	23.8	25.2	23.7	8.0	8.2	3.3	0.5	0.6	0.4	36.4	41.2	31.7
VPCR *	98.9%	98.2%	98.9%	97.5%	97.6%	97.6%	98.8%	99.0%	99.6%	99.8%	99.8%	99.9%	98.4%	98.4%	98.7%
Net Gap after 1 year	1.4	4.3		6.5	7.3		6.7	4.0		0.2	0.2		14.7	15.8	
CPCR **	99.6%	98.9%		99.3%	99.3%		99.0%	99.5%		99.9%	99.9%		99.4%	99.4%	
Net Gap after 2 years	1.1			5.8			6.7			0.2			13.8		
CPCR **	99.7%			99.4%			99.0%			99.9%			99.4%		

* Voluntary Payment Compliance Rate = the percentage of the total tax liability reported on timely-filed returns that is paid timely.

** Cumulative Payment Compliance Rate = the percentage of the total tax liability reported on timely-filed returns that is paid to date.

Frequently Asked Questions

1. Does the tax gap include illegal-source income and the underground economy?
2. What is TCMP?
3. What is NRP?
4. Can the components of the tax gap be broken out by Operating Division?
5. Can the tax gap be broken out geographically?
6. When will more recent nonfiling and underreporting data become available?
7. What published tax gap reports provide greater detail about the data and methodology?
8. Are the underreporting gap estimates based on recommended audit adjustments or on final assessments?
9. Is employer underdeposit of withheld income tax part of the individual income tax gap, or the employment tax gap?
10. What is the relationship between the tax gap and ARDI?
11. What updates to these tax gap estimates and projections are planned?
12. Can I print the Tax Gap Map without showing the hyperlinks?
13. Who should I contact for more information?

FAQ 1. Does the tax gap include illegal-source income and the underground economy?

Illegal-Source Income is *not* reflected in our estimates of total tax liability, and is therefore *not* included in our estimates of the tax gap.

- The magnitude of the illegal sector is extremely difficult to estimate.
- The interest of the government is not to derive revenue from these activities, but rather to eliminate the activities altogether. If they were eliminated, the legal sector of the economy might well be larger, with corresponding increases in tax revenue, but the magnitude of this effect is pure speculation.
- The IRS Criminal Investigation function pursues illegal activity having a tax consequence, yet it, too, does not measure the revenue generated by the cases it pursues.

The **Underground Economy** may be reflected in some components of our estimates, but the underground economy is not synonymous with the tax gap, and we avoid the term.

- The term "underground economy" means different things to different people.
- Most people would agree that some components of the tax gap are associated with the underground economy (e.g., informal suppliers).
- However, many components of the tax gap are clearly not associated with the underground economy (e.g., overstated dependent exemptions, incorrect filing status, and understated wage income).
- Likewise, some components generally considered part of the underground economy are excluded from the tax gap (e.g., the illegal sector).

FAQ 2. What is TCMP?

The **Taxpayer Compliance Measurement Program** (TCMP) was a systematic program for compiling compliance data.

- The typical survey consisted of thorough audits of a representative sample of returns for a given tax year, with line-by-line detail of all possible compliance issues.
- The surveys most used for tax gap research:
  - Phase III (filed individual income tax returns), and
  - Phase IV (filed corporation income tax returns for corporations having assets under $10 million).
- Although the TCMP audits were designed to be representative of the population, and to be as thorough as possible, they did not necessarily detect all noncompliance. Our tax gap estimates account for this non-detection. For example:
  - Our individual income tax underreporting gap estimates account for two types of income not well represented in TCMP, and for underreporting that was simply not detected in the audits.
  - Our individual income tax nonfiling gap estimates account for nonfilers among and represented by potential delinquent returns from taxpayers who could not be located, or the returns could not be secured.
- The last TCMP survey was a sample of about 54,000 individual income tax returns filed for Tax Year 1988.

FAQ 3. What is NRP?

The **National Research Program** (NRP) is a comprehensive effort by the IRS to measure compliance for different types of taxes and various sets of taxpayers. NRP provides a statistically valid representation of the compliance characteristics of taxpayers.

- Filing Compliance: We use annual Census data to estimate the number of required individual income tax returns, and IRS data to estimate the number of required returns actually filed on time. The ratio is the Filing Rate. We are also seeking to use Census data to estimate the individual income tax nonfiling gap.
- Reporting Compliance: NRP is conducting a comprehensive survey of reporting compliance on a representative sample of just under 50,000 Tax Year 2001 individual income tax returns. The study includes assembling as much information as possible to determine the potential for misreporting, then auditing the at-risk issues on those returns in the least intrusive manner possible. Studies of other types of entities are being planned.
- Payment Compliance: NRP monitors the underpayment gap by tabulating unpaid self-assessments on timely-filed returns for all types of tax for all populations of taxpayers. Unlike the other two types of noncompliance, underpayments can be observed in their entirety, and do not need to be estimated.

FAQ 4. Can the components of the tax gap be broken out by Operating Division?

The IRS has recently reorganized itself, creating four main operating divisions to serve four sub-sets of the entire taxpaying population:

- Wage and Investment (W&I) Division serving individuals who do not have any business income;
- Small Business / Self-Employed (SB/SE) Division serving individuals with business income, and corporations and partnerships reporting assets of $10 million or less;
- Large and Mid-Sized Business (LMSB) Division serving corporations and partnerships reporting assets of more than $10 million.
- Tax-Exempt and Government Entities (TEGE) Division serving exempt organizations, pension plans, and government entities.

The 2001 tax gap estimates are projected from estimates made from data compiled before the reorganization. However, we have made a **rough allocation** of the gross tax gap to the operating divisions, as follows:

Gross Tax Gap ($B)	W&I	SB/SE	LMSB	TEGE	TOTAL
Individual income tax	40.0	156.3			196.3
Corporation income tax		6.3	25.4	0.5	32.2
Employment tax		60.2	9.0	4.1	73.3
Estate & Gift tax		8.3			8.3
Excise taxes *					0.5
TOTAL	**40.0**	**231.1**	**34.4**	**4.6**	**310.6**

* Includes only the excise tax underpayment gap, which has not been tabulated by operating division.

See the underpayment gap by OD

FAQ 5. Can the tax gap be broken out geographically?

- The nonfiling and underreporting gaps cannot currently be estimated at anything other than the national level. This is primarily because many of the data sources and adjustments have no geographic detail.
- The underpayment gap tabulations could conceivably be arrayed into regional subtotals, but this would require additional programming.

FAQ 6. When will more recent nonfiling and underreporting data become available?

- **Nonfiling:** We are seeking to use Census data to estimate the individual income tax nonfiling gap. If this proves feasible, estimates should be available in early 2005.
- **Underreporting:** The first NRP dataset (of TY 2001 individual income tax returns) is scheduled to be available for analysis by the end of 2004. Tax gap estimates should then be available by the end of 2005. The second NRP survey will likely focus on flow-through entities (partnerships and S-corporations), and is in the very early planning stage.
- **Alternative sources of compliance data:** We are exploring how best to use the results of routine enforcement cases (which are not representative of the entire population) as a basis for estimating the tax gap. This may be more feasible for some types of tax (such as corporation income tax) than others.

FAQ 7. What published tax gap reports provide greater detail about the data and methodology?

1. **2002 EITC Report:** Internal Revenue Service, "Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns," February 28, 2002.
2. **1996 Individual Report:** Internal Revenue Service, "Federal Tax Compliance Research: Individual Income Tax Gap Estimates for 1985, 1988, and 1992," Publication 1415 (Rev. 4-96).
3. **Employment Tax Report:** Internal Revenue Service, "Federal Tax Compliance Research: Gross and Net Employment Tax Gap Estimates for 1984-1997," Publication 1415-E (Rev. 10-93).
4. **Net Tax Gap Report:** Internal Revenue Service, "Income Tax Compliance Research: Net Tax Gap and Remittance Gap Estimates (Supplement to Publication 7285)," Publication 1415 (Rev. 4-90).
5. **1988 Gross Tax Gap Report:** Internal Revenue Service, "Income Tax Compliance Research: Gross Tax Gap Estimates and Projections for 1973-1992," Publication 7285 (Rev. 3-88).
6. **1988 Appendices:** Internal Revenue Service, "Income Tax Compliance Research: Supporting Appendices to Publication 7285," Publication 1415 (Rev. 7-88).

Report	Individual Income Tax	Corporation Income Tax	Employment Tax	Nonfiling	Under-reporting	Under-payment	Net Tax Gap
1. 2002 EITC Report	✓				✓		✓
2. 1996 Individual Report	✓			✓	✓	✓	✓
3. Employment Tax Report			✓		✓	✓	✓
4. Net Tax Gap Report	✓	✓		✓	✓	✓	✓
5. 1988 Gross Tax Gap Report	✓	✓		✓	✓		
6. 1988 Appendices	✓	✓		✓	✓		

FAQ 8. Are The Underreporting Gap Estimates Based on Recommended Audit Adjustments or on Final Assessments?

Although some of our tax gap reports contain both types of estimates, all of the estimates in this presentation are based on audit recommendations. There are many reasons to prefer this basis alone for the estimates:

- Assessments of additional tax due represent a lower-bound estimate of underreported tax, since not all noncompliance is detected or successfully assessed. Using the recommended results compensates for this somewhat. This is particularly important for corporation income tax and employment tax, where our estimates do not account for noncompliance that is not detected.
- Increasing workloads, decreasing staff, the statute of limitations, and the “hazards” (uncertainties and costs) of litigation put pressure on both IRS and the taxpayer to settle out of court. Taxpayers are likely to anticipate higher net benefits from tax litigation than the IRS, putting downward pressure on the amount of any out-of-court settlements.
- Although neither the recommendations-based nor the assessment-based estimates perfectly represents true tax obligations, the recommendations-based estimates are the least likely to be biased. There are somewhat offsetting reasons why the recommendations-based estimates might be too high or too low, but the assessment-based estimates are certainly a lower bound on the true tax obligation.
- Providing pairs of estimates (both recommendations-based and assessment-based) causes the reader to assume that the recommendations-based estimates are upper bounds on the true amount of noncompliance, but this is not the case.
- Providing pairs of estimates is also much more cumbersome and confusing than providing point estimates—both for tables and for discussions.

FAQ 9. Is Employer Underdeposit of Withheld Income Tax Part of the Individual Income Tax Gap or the Employment Tax Gap?

It is more appropriately included with individual income tax for several reasons:

- The tax gap is defined by type of tax, rather than by who commits the noncompliance. An analogous example would be that of an individual who would likely misreport his income tax if his partnership reported the wrong income to him on Form K-1. The partner may not know that the amount is incorrect, but the underpaid individual income tax is still a part of the individual income tax gap.
- Ultimately, the tax liability that is being satisfied by employer deposits of withheld income tax is the individual's income tax liability.
- When estimates of the tax gap, total tax liability, and noncompliance rates are combined across all types of tax, we need to be careful not to double-count the same tax liability as both individual income tax and employment tax liability; it needs to be associated with one or the other, and the logical place is with individual income tax.
- Employer deposits of withheld income tax get subtracted from the individual income tax nonfiler gap, so employer *under*deposits of withheld income tax should get *added to* the individual income tax underpayment gap.

Note: underdeposits of withheld FICA tax are clearly part of the employment tax underpayment gap.

FAQ 10. What is the Relationship Between the Tax Gap and ARDI?

The Gross Tax Gap is the amount of tax that is imposed by law for a given tax year, but is not paid voluntarily and timely.

The Net Tax Gap is the portion of the Gross Tax Gap that will not be collected after all IRS and taxpayer actions have been completed for a given tax year.

The **Accounts Receivable Dollar Inventory** (ARDI) is the sum of all accrued tax, penalties and interest that have been assessed, but not yet paid. These assessments are generally made by IRS as a result of its enforcement efforts, but they also include self-assessments that taxpayers report, but do not pay timely (the underpayment gap).

ARDI	Tax Gap
A cumulative cash flow concept that includes amounts related to *many* tax years (analogous to a balance sheet)	Estimated for a *single* tax year (analogous to an income statement)
Includes assessments of interest and penalties	Excludes interest and penalties
Only the small portion of the gross tax gap that is assessed becomes a part of Accounts Receivable.	Most of the tax gap is never assessed, and so never enters ARDI.
Of the portion of a given year's tax gap that *does* eventually pass through ARDI, only a fraction of this is likely to be in Accounts Receivable at any given time. The rest has already been collected, has not yet been assessed, or has been assessed and written off.	Estimates of the net tax gap take into account the degree to which assessments have historically been collected over time; any deviation from this experience would change the net tax gap, but not the gross tax gap. Recognizing that a portion of ARDI will not be collected does not change the net tax gap estimate if the non-collection is in line with recent experience.

FAQ 11. What updates to these tax gap estimates and projections are planned?

Data are being compiled to facilitate several updates in the near future.

- **Individual income tax underreporting gap:** The new NRP data will be available for analysis by the end of 2004. Supplemental data and analyses are planned to culminate in new tax gap estimates for TY2001 by the end of 2005.
- **Individual income tax nonfiling gap:** We anticipate receiving by the end of 2004 aggregate tabulations from the Census Bureau's Exact Match study for TY1999 that will provide us with sufficient information to estimate the individual nonfiler gap.
- **Noncompliance of flow-through entities and arrangements:** The second NRP study will focus on partnerships and S-corporations. An introductory pilot study is scheduled to begin later in 2004.
- Plans are being formulated to develop new estimates of several other components of the tax gap. Some of these may be based on regular (operational) enforcement data, or some combination of operational and random data. We are also exploring the feasibility of estimating aggregate excise tax liabilities using external data.

FAQ 12. Can I print the Tax Gap Map without showing the hyperlinks?

Yes. Here's what to do:

1. Click here to locate the copy of the Tax Gap Map that does not have hyperlinks.
2. Pres the "**Esc**" key or click on the "Exit" link to end the slideshow at that slide.
3. Print the slide.

Note: Since that slide does not have navigational links, if you choose **not** to exit the slideshow there, then press the **Left Arrow** on your keyboard to return to the version of the Tax Gap Map that includes hyperlinks.

FAQ 13. Who should I contact for more information?

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